# Bonterra
Energy Corp.

1998
Annual Report

## *Corporate* Profile

Bonterra Energy Corp. (Alberta Stock Exchange symbol - BON) is a junior resource company that explores for, develops and produces oil and natural gas in the Provinces of Alberta and Saskatchewan. The Company was incorporated on February 17, 1998, and finalized its initial public offering on July 28, 1998.

The Company's business strategy is to strive to maximize shareholder value by applying long term growth objectives. The Company's primary objective is to combine its oil and gas production technical strengths with planned business strategies to generate above average results and returns for our shareholders.

## *Table of* Contents



## *Notice of* Annual Meeting

The Annual Meeting of Shareholders will be held on Monday, June 21, 1999, in the Eau Claire North Room at the Westin Hotel, 320 Fourth Avenue S.W., Calgary, Alberta, at 11:00 a.m. (Calgary time).

# Highlights

The Company made a major oil and gas producing property acquisition in 1998. The effective date for this acquisition is November 1, 1998 and therefore the following operational highlights mainly represent Company activity for a two month period.

| | | 1998 |
|---|---|---|
| **Financial** ($000, *except $ per share*) | | |
| Revenue – oil and gas (*net of royalties*) | $ | 2,131 |
| Cash Flow from Operations | | 395 |
| Per Share | | 0.05 |
| Net Loss | | 201 |
| Per Share | | 0.03 |
| Capital Expenditures and Acquisitions | | 20,791 |
| Long-term Debt | | 17,884 |
| Shareholders' Equity | | 2,227 |
| Shares Outstanding (*weighted average*) (000's) | | 7,535 |
| **Operations** | | |
| Oil and Liquids (*barrels per day*) | | 397 |
| Average Price ($ *per barrel*) | $ | 16.70 |
| Natural Gas (MCF *per day*) | | 164 |
| Average Price ($ *per* MCF) | $ | 2.54 |
| **Reserves** (*proved producing*) | | |
| Oil and Liquids (*barrels in* 000's) | | 7,329 |
| Natural Gas (MCF *in* 000's) | | 4,233 |

## *Report to* Shareholders

*It is with great pleasure that we present to our shareholders the Company's first annual report. The Board of Directors wish to take this opportunity to welcome our new shareholders. We look forward to a successful and beneficial association.*

*Bonterra became a publicly traded corporation on The Alberta Stock Exchange in July, 1998. Prior to that date we issued approximately 15,750,000 common shares from treasury at a price of $0.20 per share to raise capital of approximately $3,000,000 on a net basis.*

### *Major Property Acquisition*

In December, 1998, the Company acquired oil and gas producing properties for $19,700,000. The total daily production is approximately 1,700 barrels of oil equivalent (BOE) per day, consisting mainly of light sweet gravity oil produced in the Provinces of Alberta and Saskatchewan. Approximately 1,250 BOE of the production is from the Cardium formation in the Pembina area of Alberta. The balance of the production is from the Viking zone in the Dodsland area of southwest Saskatchewan and the Midale zone in the Pinto area of southeast Saskatchewan. Bonterra is the operator for the major portion of this production, having taken over operatorship effective January 1, 1999.

The Company's estimate of proven reserves acquired are 7,850,000 BOEs. These reserves have a life index exceeding 11 years which is much higher than industry average. Financing for this acquisition was provided by cash on hand and loans from the Company's principal banker and Comstate Resources Ltd. (Comstate). Initially Bonterra will not hire any salaried employees and will operate by engaging Comstate management and operational services on a fee for service basis. This arrangement will assist in reducing costs and will enable the Company to reduce debt in a more efficient manner.

The effective date for this transaction was November 1, 1998. Despite low oil prices and high operating and start up costs, we were still able to generate cash flow of approximately $400,000 for the fiscal period. Management anticipates that it will be able to substantially decrease operating costs and slightly increase production which will result in an increase in future cash flow.

### *Share Split*

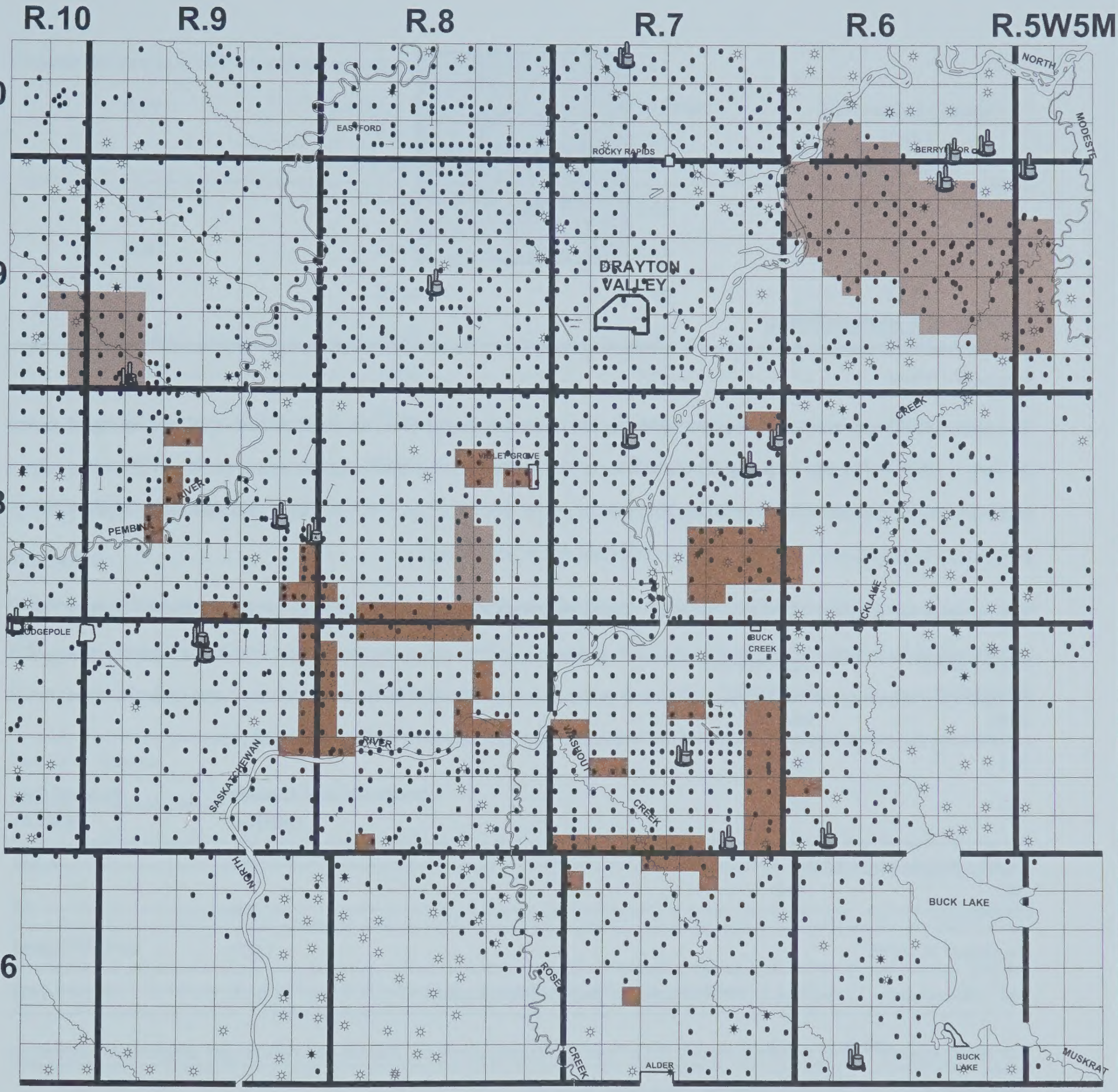
Since we completed our public issue we have received suggestions on numerous occasions that we do not have a large enough public float of common shares. After considering alternative ways of correcting this situation, the Board concluded that the shareholders be approached to approve a subdivision of the issued common shares on a two new for one old basis (i.e. if you presently own 1,000 shares you will receive another share certificate for 1,000 shares). This increase in issued shares should assist in providing more purchasing interest and opportunities in the marketplace. Shareholder approval is requested at this year's annual meeting.

### *Corporate*

The Company is optimistic about its future. Initially management will focus on debt reduction and in the near future will redirect its efforts towards exploration and development drilling and additional producing property acquisitions.

Submitted on behalf of the Board of Directors,

George F. Fink
President and Director




Bonterra
Energy Corp.

# PEMBINA FIELD

BONTERRA OPERATED LANDS
BONTERRA NON-OPERATED LANDS
PRODUCING GAS WELL
PRODUCING OIL WELL
GAS PLANTS

## *Review of* Operations

### *Reserves*

The enclosed reserve evaluation was prepared by the Company based upon an independent engineering report dated January 1, 1998, which was prepared for the vendor of the properties that the Company acquired. The engineering report was adjusted by management by reducing commodity prices, taking out probable reserves, and making an adjustment for production from January 1, 1998, to the effective date of our acquisition.

The reserves are located in the Provinces of Alberta and Saskatchewan. The majority of the Company's production is comprised of light sweet crude which results in higher oil prices and more and better marketing opportunities. The Company's main oil producing areas are located in the Pembina area of Alberta and Dodsland area of Saskatchewan. Oil and natural gas proven reserve estimates at December 31, 1998, before royalties, are as follows:

| | **Crude Oil and Liquids (MBbls)** | **Natural Gas (MMCF)** |
|---|---|---|
| Additions from acquisitions | 7,455 | 4,285 |
| Production | 126 | 52 |
| December 31, 1998 | 7,329 | 4,233 |
| Life index (years) – December 31, 1998 (based on year end production) | 11.8 | 13.8 |

The above reserve numbers reflect strictly the proved producing crude oil, liquids and natural gas amounts calculated as described above. No probable amounts have been included.

The reserve values in the following table, "Estimated Present Worth of Reserves", are based upon proved producing reserve estimates as at December 31, 1998, calculated as described above.

### ESTIMATED PRESENT WORTH OF RESERVES

| | Discounted at | | | |
|---|---|---|---|---|
| (millions of dollars) | 0% | 10% | 15% | 20% |
| Proved producing as at December 31, 1998 | 62.9 | 32.7 | 27.3 | 22.4 |

Commodity prices used in the above calculations of reserves are as follows:

| Year | Edmonton Par Price (Cdn $ per barrel) | AECO Price (Cdn $ per MCF) | Natural Gas Liquids (Cdn $ per barrel) |
|---|---|---|---|
| 1999 | 23.67 | 2.48 | 16.01 |
| 2000 | 24.94 | 2.44 | 16.50 |
| 2001 | 25.56 | 2.46 | 17.02 |
| 2002 | 26.20 | 2.51 | 17.54 |
| 2003 | 26.85 | 2.56 | 18.09 |
| 2004 | 27.39 | 2.61 | 18.65 |
| 2005 | 27.94 | 2.66 | 19.23 |

Prices escalate at 2% per year thereafter.

### *Production*

The following table provides a summary of exit production volumes from our main producing areas.

| | **Oil and NGL (Bbls/day) 1998** | **Natural Gas (MCF/day) 1998** |
|---|---|---|
| Pembina, Alberta | 1,243 | 525 |
| Dodsland, Saskatchewan | 380 | 232 |
| Pinto, Saskatchewan | 72 | 83 |
| | 1,695 | 840 |

### *Land Holdings*

The Company's holdings of petroleum and natural gas leases and rights are as follows:

| | **1998** | |
|---|---|---|
| | **Gross Acres** | **Net Acres** |
| Alberta | 34,114 | 26,160 |
| Saskatchewan | 29,630 | 17,768 |
| | 63,744 | 43,928 |

### *Acquisitions and Drilling*

During 1998, the Company's acquisitions of oil and natural gas properties as outlined above resulted in total acquisition costs averaging $2.60 per barrel of oil equivalent of proved producing reserves. The Company also participated in one (.33 net) exploration well (dry hole) in the Lesser Slave Lake area of Alberta. The total cost of $276,834 relating to land and drilling has been expensed.

## *Property* Discussions

### *Pembina Area*

The Pembina properties are situated in the center of the Pembina Cardium field located approximately 100 kilometers southwest of Edmonton, Alberta. Production was discovered in the mid 1950's and has been expanded by extensive drilling since then. Light sweet oil and solution gas are produced from the Cardium sandstone formation from a depth of approximately 5,000 feet. Pressure maintenance by water injection commenced in the 1960's and continues, resulting in low production decline rates and a long economic life.

Bonterra acquired various working interests in 34,114 acres of land in this area. The properties contain 101 gross (84.7 net) operated wells with an 83.9 percent average working interest and 189 gross (32.1 net) non-operated wells with an approximate 17 percent average working interest. Non-operated properties consist of interests in the Berrymoor Unit and Pembina Cardium Units # 4 and # 8. Average daily production from the Pembina properties is approximately 1,300 BOE per day. Approximately 75 percent of this production is operated by Bonterra.

### *Dodsland Area*

The Dodsland properties are located in southwest Saskatchewan and produce light sweet gravity oil and solution gas from the Viking Sandstone formation at a depth of approximately 2,300 feet.

Bonterra acquired various working interests in 18,840 gross (7,488 net) acres of land in this area. The properties contain approximately 400 gross (350 net) operated oil wells with an 88 percent average working interest. Average daily production from this area is approximately 400 BOE per day. A positive feature with regard to this property is that Bonterra has an option to transfer uneconomic wells to a previous owner so that Bonterra is not burdened by abandonment costs. During the next few months the Company will be conducting an extensive evaluation program on the wells on this property. Production from this formation has low decline rates and a long economic life.

### *Pinto Area*

The Pinto properties are located approximately 30 kilometers southwest of Estevan in southeast Saskatchewan. Bonterra acquired and operates a 94.24 percent working interest in the South Pinto Unit and a 96.5 percent working interest in non-unit properties. Production of approximately 80 BOE per day of light sweet gravity oil and solution gas is from the Midale formation. Production in the Unit commenced in 1957 with major development continuing until 1965 when a water injection system was started. Production from this formation has very low decline rates. During the next few months the Company will be initiating rework programs on producing and shut in wells to maximize production from this area.

## *Management's Discussion and* Analysis

This report is a review of the operations, current financial position and outlook for the Company and should be read in conjunction with the audited financial statements for the fiscal period ended December 31, 1998, together with the notes related thereto.

The fiscal period ended December 31, 1998, is a first for the Company. The Company was incorporated on February 17, 1998, and commenced trading on The Alberta Stock Exchange on July 28, 1998, with its initial public offering. The Company acquired a nominal amount of production effective March 1, 1998, followed by a major $19,675,000 acquisition effective November 1, 1998. The focus of the following discussions deal with the 1998 impact of these acquisitions and the projected future benefits.

### *Production*

The Company's average production of oil and natural gas liquids was 397 barrels per day and 164 MCF per day of natural gas based on the period February 17, 1998, to December 31, 1998. The majority of production occurred during the final two months of 1998. Exit production was approximately 1,695 barrels per day of oil and natural gas liquids and 840 MCF per day of natural gas. The Company is in the process of reviewing production rates and operating costs of individual wells acquired. The Company's operators in these areas are very experienced and will be applying known techniques that have proved successful in Pembina, Dodsland and Pinto.

### *Revenue*

Gross revenue from petroleum and natural gas sales was $2,240,452. The average price received for crude oil was $16.86 per barrel, $2.54 per MCF of natural gas, and $10.07 per barrel of natural gas liquids. Due to the vast majority of the commodity sales occuring in November and December, 1998, the average prices for the fiscal period reflect the low crude oil prices that existed during the past few months.

### *Royalties*

Royalties paid by the Company consist primarily of Crown royalties paid to the Provinces of Alberta and Saskatchewan. During the 1998 fiscal period, the Company paid $95,256 in Crown royalties and $14,043 in freehold and gross overriding royalties. The majority of the Company's wells in Saskatchewan are low oil producers that have production rates lower than the Saskatchewan floor volumes for Crown oil charges. In addition, the Pembina Alberta oil wells are low production wells that have a Crown royalty rate averaging approximately 6 percent.

The Company is not eligible for any rebates of its Alberta Crown royalties as the properties acquired were previously owned by above limit corporations.

### *Production Costs*

Production costs totaled $1,436,287 during the 1998 fiscal period. On a barrel of oil equivalent basis (using 10 MCF to 1 barrel of oil) operating costs were $10.93. Due to low production rates per well, operating costs on a barrel of oil equivalent will tend to be higher than industry average.

The Company is reviewing the economics on a well by well basis to determine if cost savings can be accomplished with minimal production loss. An examination is also ongoing regarding methods of operations that could be used to enhance production from existing oil wells and to reduce operating costs.

### *General and Administrative Expense*

General and administrative expenses incurred during the approximate 10.5 month period ending December 31, 1998, were $60,666 or $0.46 per barrel of oil equivalent. The Company has entered into a management agreement with Comstate to provide field operations, production accounting and general office services. Fees for the services are charged on a per well basis. In addition, a flat fee of $5,000 per month is charged for general office services. Fees associated with well operations and production and operational accounting are charged to production costs as incurred. The Company has not capitalized any general and administrative expenses in 1998.

### *Interest Expense*

Interest expense for the fiscal period ending December 31, 1998, totaled $249,978. Of this amount, $229,567 was incurred as a result of the November 1, 1998 acquisition. At December 31, 1998, the Company had outstanding loans to Comstate ($8,200,000) and to the Royal Bank of Canada ($9,683,758). Interest rate charges on the outstanding debt to Comstate is prime plus one percent and to the Royal Bank prime plus one half of a percent. The Company has the ability to use Bankers Acceptances (BA's) as part of its loan facility. Interest charges on BA's are generally three quarters of a percent lower than that charged on the general loan account.

### *Depletion, Depreciation, Future Site Restoration and Dry Hole Costs*

The Company depletes its oil and natural gas intangible assets using the unit of production basis by field. For tangible assets such as well equipment, an average of a ten year life span is estimated and the related tangible costs are depreciated at 1/10 of original cost per year. Provision is made for future site restoration based on management's estimation of abandonment requirements using current costs and amortized on a unit of production basis by field.

For the fiscal period ending December 31, 1998, the Company had a total provision for the above mentioned items of $425,981. As the majority of the petroleum and natural gas assets were acquired effective November 1, 1998, only two months of depletion, depreciation and amortization of future site restoration were recorded on these properties.

The Company follows the successful efforts method of accounting for petroleum and natural gas exploration and development costs. Under this method, the costs associated with dry holes are charged to operations. During the fiscal period, the Company participated in the drilling of one (.33 net) exploration well. The well was unsuccessful and therefore the costs of $276,834 associated with the land acquisition and drilling were charged to operations in 1998.

### *Income Taxes*

Current taxes of $38,000 consist entirely of taxes related to federal large corporation tax and the Saskatchewan resource surcharge. The Company currently has sufficient tax deductions so that no federal or provincial income tax is owing.

### *Net Loss*

The Company incurred a net loss of $200,942 during its fiscal period ending December 31, 1998. The two key factors contributing to the net loss were dry hole costs of $276,834 and low oil prices.

Given the low cost per barrel of oil equivalent ($2.60) for its acquisitions in 1998 and the continued current increase in crude oil prices, the Company is well positioned to have substantial earnings potential in the future.

### *Cash Flow From Operations*

Cash flow from operations for the fiscal period ending December 31, 1998, was $394,953 or approximately $0.05 per weighted average shares outstanding during 1998.

### *Cash Netback*

The following table illustrates the cash netback received and its components:

| **$ per BOE** | **1998** |
|---|---|
| Production volumes (BOE) | 131,388 |
| Gross production revenue | $ 17.05 |
| Net royalties | (0.83) |
| Field operating | (10.93) |
| Field netback | 5.29 |
| General and administrative | (0.46) |
| Interest | (1.90) |
| Taxes | (0.29) |
| Cash flow | $ 2.64 |

### *Liquidity and Capital Resources*

At December 31, 1998, the Company had bank debt of $9,683,758. Bonterra's credit facility at year end consisted of a revolving line of credit of $9,800,000 and carried an interest rate of one half percent above bank prime. The credit facility is reduced commencing June 30, 1999, by $1,000,000 and a further $100,000 per month thereafter. The credit facility allows for borrowings by means of Bankers Acceptances (BA's). The effective interest rates of the BA's are between 1/2 and 3/4 of a percentage point lower than that available under the normal credit facility. The Company attempts to maximize the amount of its credit facility financed by BA's to reduce overall interest costs. Collateral for the loan consists of a demand debenture providing a first floating charge over all of the Company's assets and a general security agreement.

The Company has negotiated an $8,200,000 loan from Comstate to assist in financing its November 1, 1998 acquisition. Repayments of the loan as well as accrued interest payments require prior approval from the Royal Bank. Comstate has not taken specific security for the loan but reserves the right to obtain secondary charges over Bonterra's oil and gas properties. Due to the secondary nature of the loan, the interest rate charged by Comstate is Royal Bank prime plus one percent compounded quarterly.

During 1998, Bonterra completed its Initial Public Offering (IPO) by distributing 15,755,948 shares to shareholders of Comstate through a rights offering for total proceeds of $3,151,190. The Company incurred $133,566 of costs associated with the IPO.

At December 31, 1998, the Company has 1,434,000 stock options issued under its Stock Option Plan. The options which become available at one third per year commencing January 29, 1999, must be exercised on or before May 1, 2003. The stock options were cleared as part of the IPO Prospectus and are all priced at $0.20.

## *Business Prospects, Risks, Y2K Process and Outlooks*

The resource industry operates with a great deal of risk. The most significant risks may come from oil and natural gas price swings, the uncertainty of finding new reserves from drilling programs or acquisitions, competition within the industry, and increasing environmental controls and regulations.

The prices received for crude oil are established by world market forces and for natural gas by forces within North America. Fluctuations in pricing can have extremely positive or negative effects on the Company's cash flow or in the value of its producing and non producing oil and natural gas properties.

Bonterra presently attempts to minimize these risks by pursuing both oil and natural gas activities. The Company may sometimes elect to protect against price fluctuation by using commodity hedging. The Company operates its oil and natural gas interests in areas where it has the technical expertise to enhance production, control operating costs and to increase margins of profit.

The Company has a management agreement with Comstate Resources Ltd. to provide all management and computer systems. The Company has been assured by Comstate that they have reviewed their exposure to the Year 2000 computer issue. Management of Comstate advised that it has reviewed its software systems and had an independent computer consulting firm review its hardware and office network. Comstate has also advised that it has received from its software suppliers updates correcting the Year 2000 issue or has received commitments to upgrade all primary software by August, 1999, and that the vast majority of Comstate's current computer hardware is 2000 reliable and the balance that is not will be replaced or upgraded prior to the end of 1999.

The Company has reviewed its field operations for potential Y2K problems. Based on reviews to date no significant problems were discovered. The Company has verbally discussed the Y2K issue with its crude and natural gas purchasers as well as pipeline and plant operators. These organizations are in management's opinion essential to the continued operations of the Company. To date no organizations have indicated to the Company that they will not be Y2K compliant. The Company plans to maintain sufficient field and office supplies on hand as of December 31, 1999, to ensure the continued operations should Y2K problems surface.

### *Sensitivity Analysis*

Sensitivity analysis as estimated for 1999 follows:

| | **Cash Flow** | **Cash Flow Per Share** |
|---|---|---|
| U.S. $1.00 per barrel | $ 890,000 | $ 0.056 |
| Canadian $0.10 per MCF | $ 25,000 | $ 0.002 |
| Change of Canadian $0.01/U.S. $ exchange rate | $ 208,000 | $ 0.013 |

## *Management's Responsibility for* Financial Statements

The information provided in this report, including the financial statements, is the responsibility of management. In the preparation of the statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate in the preparation of relevant and timely information.

Deloitte & Touche LLP have been appointed by the shareholders to serve as the Company's external auditors. They have examined the financial statements and provided their auditors' report. The audit committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors. The Board of Directors has approved the statements as presented in this annual report.

Garth Schultz

Garth E. Schultz

Vice President, Finance

## *Auditors'* Report

To the Shareholders of Bonterra Energy Corp.:

We have audited the balance sheet of Bonterra Energy Corp. as at December 31, 1998 and the statements of loss and changes in financial position from the date of incorporation, February 17, 1998 to December 31, 1998. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998, and the results of its operations and the changes in its financial position from the date of incorporation, February 17, 1998 to December 31, 1998 in accordance with generally accepted accounting principles.

Calgary, Alberta

March 26, 1999

Deloitte & Touche LLP

Chartered Accountants

# *Balance* Sheet

**As at December 31**

| | 1998 |
|---|---|
| ***Assets*** | |
| **Current** | |
| Accounts receivable | $ 800,571 |
| Inventories | 281,541 |
| | 1,082,112 |
| Future income tax asset (*Note* 6) | 371,833 |
| **Property and equipment** (*Note* 3) | |
| Property and equipment | 20,034,595 |
| Accumulated depletion and depreciation | (289,952) |
| Net property and equipment | 19,744,643 |
| | $ 21,198,588 |
| ***Liabilities*** | |
| **Current** | |
| Bank indebtedness | $ 2,225 |
| Accounts payable and accrued liabilities | 574,066 |
| Current portion of long term debt (*Note* 4) | 1,600,000 |
| | 2,176,291 |
| Long term debt (*Note* 4) | 16,283,758 |
| Future site restoration | 136,029 |
| | 18,596,078 |
| ***Shareholders' Equity*** | |
| Share capital (*Note* 5) | 3,077,729 |
| Excess of cost of petroleum and natural gas properties | |
| over related net book value of vendor corporation (*Note* 3) | (274,277) |
| Deficit | (200,942) |
| | 2,602,510 |
| | $ 21,198,588 |

On behalf of the Board:

Director

Carl R. Jonsson

Director

## *Statement of* Loss

Period from Date of Incorporation, February 17, 1998 to December 31, 1998

| | 1998 |
|---|---|
| **Revenue** | |
| Oil and gas sales, net of royalties of $109,299 | $ 2,131,153 |
| Production costs | (1,436,287) |
| Interest and other | 48,731 |
| | 743,597 |
| **Expenses** | |
| General and administrative | 60,666 |
| Interest on long term debt | 249,978 |
| | 310,644 |
| **Cash flow from operations before current income taxes** | 432,953 |
| Depletion, depreciation and future site restoration | 425,981 |
| Dry hole costs | 276,834 |
| | 702,815 |
| **Loss before income taxes** | 269,862 |
| Income taxes (*Note* 6) | |
| Current | 38,000 |
| Future | (106,920) |
| | (68,920) |
| **Net loss for the period** | $ 200,942 |
| **Net loss per share** | $ (0.03) |

## *Statement of Changes in* Financial Position

Period from Date of Incorporation, February 17, 1998 to December 31, 1998

| | 1998 |
|---|---|
| **Operating Activities** | |
| Net loss for the period | $ (200,942) |
| Items not affecting cash | |
| Depletion, depreciation and future site restoration | 425,981 |
| Dry hole costs | 276,834 |
| Future income taxes | (106,920) |
| Cash flow from operations | 394,953 |
| Change in non-cash operating working capital items | (508,044) |
| | (113,091) |
| **Financing Activities** | |
| Increase in long term debt | 17,883,757 |
| Issuance of common shares | 3,151,191 |
| Share issue costs | (133,566) |
| | 20,901,382 |
| **Investing Activities** | |
| Property and equipment expenditures | (20,790,516) |
| **Bank indebtedness, end of year** | $ (2,225) |

# *Notes to the* Financial Statements

Period from Date of Incorporation, February 17, 1998 to December 31, 1998

## 1. INCORPORATION

The Company was incorporated in the Province of Alberta on February 17, 1998. The financial statements represent the operations of the Company from this date to December 31, 1998.

## 2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements necessarily involves the use of estimates and approximations which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

**Property and Equipment**

*Petroleum and Natural Gas Properties and Related Equipment*

The Company follows the successful efforts method of accounting for petroleum and natural gas properties and related equipment. Costs of acquiring unproved properties are capitalized and amortized on a straight line basis over the lives of the related leases. When property is found to contain proved reserves as determined by Company engineers, the related net book value is depleted on the unit-of-production basis, calculated by field. The costs of dry holes and abandoned properties are charged to operations. Geological costs, lease rentals and carrying costs are charged to income as incurred. Costs of drilling exploratory and development wells that result in additions to proved reserves are capitalized and depleted on the unit-of-production basis. Tangible equipment is depreciated on a straight line basis over ten years.

**Income Taxes**

The Company follows the tax payable method of accounting under which the income tax provision is based on the temporary timing differences in the accounts calculated using current income tax rates. Under this method, the Company makes full provision for income taxes deferred principally as a result of claiming capital cost allowances and exploration and development costs in excess of depletion, depreciation, dry hole costs and property abandonments.

**Future Site Restoration**

The Company provides for future site restoration and abandonment costs over the estimated production life of its property and equipment. Estimates of these amounts are based on the anticipated method and extent of site restoration using current costs and in accordance with existing legislation and industry practice. The annual charge is included with depletion, depreciation and future site restoration.

**Joint Interest Operations**

A significant portion of the Company's oil and gas operations are conducted with other parties and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

**Inventories**

Inventories consist of products that are valued at current market price as of December 31, 1998.

**Net Loss Per Common Share**

Net loss per common share is calculated using the weighted average number of common shares outstanding during the period which was 7,535,279. The exercise of outstanding stock options would have no dilutive effect on net loss per common share.

## 3. PROPERTY AND EQUIPMENT

| | 1998 | |
|---|---|---|
| | Cost | Accumulated Depletion and Depreciation |
| Petroleum and natural gas properties | | |
| and related equipment | $20,034,595 | $ 289,952 |
| | $20,034,595 | $ 289,952 |

During 1998, the Company acquired petroleum and natural gas properties for total consideration of $20,790,516. The effective date for 95 percent of these acquisitions is November 1, 1998.

Effective March 1, 1998, the Company acquired minor oil and gas properties. The purchase price was $700,000 and was paid by the Company to Comstate Resources Ltd. (Comstate) which was a related party to the Company. The Company, due to the related party status, is required to record the oil and gas properties acquired at Comstate's carrying value which was $221,000. The difference between the purchase price and the carrying value, net of future income taxes, has been charged directly against shareholders' equity.

## 4. LONG TERM DEBT

The Company has a long term bank revolving credit facility of $9,800,000 at December 31, 1998. The terms of the credit facility provide that the loan is due on demand. Repayment consists of a $1,000,000 payment due June 30, 1999, and monthly payments of $100,000 commencing July 31, 1999. Collateral for the loan consists of a demand debenture providing a first floating charge over all of the Company's assets, and a general security agreement. The credit facility carries an interest rate of one half percent above Canadian chartered bank prime.

At December 31, 1998, the Company owes $8,200,000 plus accrued interest of $24,375 to Comstate. The loan is repayable upon demand subject to prior approval by the Company's banker, is unsecured, and bears interest at one percent above Canadian chartered bank prime. The Company has engaged the services of Comstate to provide management and operational services on a fee basis for operating the Company's petroleum and natural gas properties.

## 5. SHARE CAPITAL

**Authorized**

The Company is authorized to issue an unlimited number of common shares without nominal or par value

| **Issued** | **1998** | |
|---|---|---|
| | **Number** | **Amount** |
| **Common shares** | | |
| Common shares issued | 15,755,953 | $3,077,729 |
| Balance, end of year | 15,755,953 | $3,077,729 |

On July 28, 1998, the Company completed its Initial Public Offering (IPO) by way of a Rights Offering. Total shares issued by the IPO were 15,755,948 for proceeds of $3,077,728. The proceeds are after share issue costs of $73,461 which is net of future income taxes of $60,105.

At December 31, 1998, the Company had reserved 2,250,000 common shares for issue under the terms of a Stock Option Plan. At December 31, 1998, options were outstanding to service providers for 1,470,000 common shares at a price of $0.20 per share. The outstanding stock options are exercisable on or before May 1, 2003.

## 6. INCOME TAXES

The Company has recorded a future income tax asset. The asset relates to the following temporary differences:

| | **1998 Amount** |
|---|---|
| Temporary differences related to assets and liabilities | $ (321,146) |
| Finance expense charged to shareholders' equity | 37,793 |
| Tax loss carryforward | 655,186 |
| | $ 371,833 |

Income tax expense varies from the amounts that would be computed by applying Canadian federal and provincial income tax rates as follows:

| | 1998 |
|---|---|
| Loss before income taxes | $ (269,862) |
| Combined federal and provincial income tax rates | 45% |
| Income tax provision (recovery) calculated using statutory tax rates | (121,438) |
| Increase (decrease) in income taxes resulting from: | |
| Non-deductible Crown royalties | 43,330 |
| Resource allowance | (33,119) |
| Other | 4,307 |
| Capital taxes | 38,000 |
| | $ (68,920) |

The Company has the following tax pools which may be used to reduce taxable income in future years, limited to the applicable rates of utilization:

| | Rate of Utilization % | Amount |
|---|---|---|
| Undepreciated capital costs | 25-30 | $ 3,672,917 |
| Canadian oil and gas property expenses | 10 | 14,973,818 |
| Canadian development expenses | 30 | 7,955 |
| Canadian exploration expenses | 100 | 197,492 |
| Finance expenses | 20 | 157,448 |
| Tax loss carryforward | 100 | 1,455,969 |
| | | $ 20,465,599 |

## 7. FINANCIAL INSTRUMENTS

The carrying value of the financial instruments of the Company approximates their estimated fair values. Financial instruments include accounts receivable, accounts payable and accrued liabilities, and current and long term debt.

## 8. SUBSEQUENT EVENT

Subsequent to year end the Company entered into the following commodity hedging transaction for its crude oil production:

| Period of Agreement | Volume (barrels) per day | Price per barrel |
|---|---|---|
| April 1, 1999 to December 31, 1999 | 700 | $23.60 |

## 9. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000 and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of joint interest partners, suppliers, or other third parties will be fully resolved.

# Corporate Profile

## Head Office

Suite 901, 1015 Fourth Street S.W.
Calgary, Alberta
T2R 1J4
Telephone: (403) 262-5307
Fax: (403) 265-7488

## Registered Office

Suite 3400, 150 - 6th Avenue S.W.
Calgary, Alberta
T2P 3Y7

## Board of Directors

R. J. Balfour
Ottawa, Ontario

G. F. Fink
Calgary, Alberta

C. R. Jonsson
Vancouver, British Columbia

F. W. Woodward
Calgary, Alberta

## Officers

G. F. Fink - President
R. M. Jarock - Vice President, Acquisitions
G. E. Schultz - Vice President,
Finance, and Secretary

## Registrar and Transfer Agent

Montreal Trust
Calgary, Alberta

## Auditors

Deloitte & Touche
Calgary, Alberta

## Solicitors

Parlee McLaws
Calgary, Alberta

Tupper, Jonsson & Yeadon
Vancouver, British Columbia

## Bankers

The Royal Bank of Canada
Calgary, Alberta

## Stock Listing

The Alberta Stock Exchange
Calgary, Alberta

Trading Symbol: BON

Bonterra
Energy Corp.

901, 1015 – 4th Street SW
Calgary, Alberta T2R 1J4